

SURREBUTTAL TESTIMONY AND EXHIBITS

OF

DAWN M. HIPPI

ON BEHALF OF

THE SOUTH CAROLINA OFFICE OF REGULATORY STAFF

DOCKET NO. 2019-281-S

IN RE: APPLICATION OF PALMETTO UTILITIES, INC. FOR

ADJUSTMENT (INCREASE) OF RATES AND CHARGES, TERMS AND

CONDITIONS, FOR SEWER SERVICE PROVIDED TO CUSTOMERS IN

ITS RICHLAND AND KERSHAW COUNTY SERVICE AREAS

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND OCCUPATION.

A. My name is Dawn M. Hipp. My business address is 1401 Main Street, Suite 900, Columbia, South Carolina 29201. I am employed by the State of South Carolina as the Chief Operating Officer of the Office of Regulatory Staff ("ORS").

Q. DID YOU FILE DIRECT TESTIMONY RELATED TO THIS PROCEEDING?

A. Yes. I filed direct testimony with the Public Service Commission of South Carolina ("Commission") on May 26, 2020.

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY IN THIS PROCEEDING?

A. The purpose of my surrebuttal testimony is to respond to the rebuttal testimony filed by Palmetto Utilities, Inc. ("PUI" or "Company") on June 9, 2020. Specifically, I will respond to the objections and complaints expressed by PUI witnesses William Crawford and Mark Daday on the conduct of ORS staff members as they performed their

legislatively established duties to review, investigate and make recommendations to the Commission with respect to the rates charged or proposed to be charged by PUI. Specifically, I will respond to PUI witness Crawford's complaints that ORS's efforts between PUI's rate cases did not meet the demands and expectations of the Company. Finally, I will present and discuss possible regulatory alternatives for the Commission to examine and consider which may serve as a basis to resolve the disputes related to ratemaking treatment for the PUI wastewater collection system serving PUI customers in the former Palmetto of Richland County service area ("PRC Assets") and the return to customers of the regulatory liability required by the Commission for excess federal corporate income tax expense that PUI is authorized to collect through rates from its customers since January 1, 2018 due to the 2017 Tax Cuts and Jobs Act ("TCJA").

Q. DO YOU ATTEMPT TO ADDRESS COMPANY WITNESSES CRAWFORD AND DADAY'S ASSERTIONS THAT ORS'S TESTIMONY IS FACTUALLY INCORRECT BECAUSE ORS DID NOT CONDUCT DISCOVERY?

A. No. The Company's claims and assertions that ORS did not conduct discovery and therefore, ORS witnesses Daniel P. Hunnell II and Charles E. Loy's direct testimonies are not "factually accurate" are premised on legal arguments made by the Company. I do not address these legal arguments as I am not a lawyer.

ORS's Legislatively Established Duties and Responsibilities

Q. PLEASE PROVIDE AN OVERVIEW OF ORS'S STATUTORY DUTY.

A. The South Carolina General Assembly ("General Assembly") made a public policy and regulatory decision to change the statutory duties and responsibilities assigned to ORS in June 2018 through Act 258 which is reflected in S.C. Code Ann. § 58-4-10 as:

1 The regulatory staff must represent the public interest of South Carolina
2 before the commission. For purposes of this chapter, 'public interest' means
3 the concerns of the using and consuming public with respect to public utility
4 services, regardless of the class of customer and preservation of continued
5 investment in and maintenance of utility facilities so as to provide reliable
6 and high quality utility services.

7 Prior to July 2018, ORS's statutory duty was quite different and shown here for comparison
8 purposes:

9 The regulatory staff must represent the public interest of South Carolina
10 before the commission. For purposes of this chapter, 'public interest' means
11 a balancing of the following:
12 (1) concerns of the using and consuming public with respect to public utility
13 services, regardless of the class of customer;
14 (2) economic development and job attraction and retention in South
15 Carolina; and
16 (3) preservation of the financial integrity of the state's public utilities and
17 continued investment in and maintenance of utility facilities so as to provide
18 reliable and high quality utility services.¹

19 The General Assembly narrowed and revised ORS's statutory duty. This revision clarified
20 and directed that the Commission was to consider a utility's financial integrity in arriving
21 at a final decision after carefully weighing the evidence from all parties. The significant
22 change to further amend the definition of the "public interest" was in direct response to an
23 investor-owned utility's abandonment of a nuclear construction project in South Carolina.
24 The amendment conveyed the desire of the General Assembly for open and transparent
25 regulation of the state's public utilities. As evidenced by the rebuttal testimony by PUI
26 witness Crawford (p.8 lines 7 and 8), PUI fails to recognize the significant changes made
27 by the General Assembly to ORS's statutory duties and responsibilities.

28 **Q. PLEASE EXPLAIN HOW THE CHANGE IN ORS'S STATUTORY DUTY TO**
29 **REPRESENT THE PUBLIC INTEREST IMPACTS THE MANNER IN WHICH**

¹ 2004 Act No. 175.

**THE ORS STAFF REVIEW, INVESTIGATE AND MAKE APPROPRIATE
RECOMMENDATIONS TO THE COMMISSION IN A RATE PROCEEDING.**

A. In a rate proceeding, ORS has the sole responsibility to make inspections, audits and examinations of public utilities that make application to the Commission for a change in rates to be charged to customers. Upon completion of the inspection, audit and examination, it is ORS's duty to provide the Commission with the results of the ORS review in a manner consistent with the requirements placed on ORS by the General Assembly. ORS must provide relevant data to the Commission in an open and transparent manner to enable the Commission to arrive at a decision weighing all the evidence. Likewise, it is ORS's responsibility to make appropriate recommendations consistent with the requirements placed on ORS by the General Assembly.

**Q. ARE THE ORS RECOMMENDATIONS ALWAYS ACCEPTED BY THE
COMMISSION?**

A. The Commission serves a very important role made even more critical by the General Assembly's change to the definition of public interest in section 58-4-10. The Commission's regulatory process enables all parties an opportunity to represent their varied interests in an unbiased and transparent manner while ensuring the outcome is fair and reasonable. The Commission has never "rubber stamped" ORS's rate case recommendations and various rate case proposals offered by ORS over the years were not accepted or adopted by the Commission.

PUI's Objections and Complaints and ORS Response

**Q. PLEASE ADDRESS THE ASSERTIONS BY COMPANY WITNESSES
CRAWFORD AND DADAY IN THE COMPANY'S REBUTTAL TESTIMONY
THAT CLAIM ORS CONDUCTED ITS DUTIES IN A NON-CONSTRUCTIVE,**

ADVERSARIAL, IMPROPER, AGGRESSIVE, RETALIATORY, UNFAIR, UNPROFESSIONAL, INACCURATE, AND INEQUITABLE MANNER.

A. The rebuttal testimonies of Company witnesses Crawford and Daday reflect what appears to be both frustrations and objections with the procedures ORS regularly employs to carry out its statutory duties and responsibilities related to rate case preparation. Furthermore, Company witnesses Crawford and Daday appear to attempt to limit the scope of the Commission's review of the Application by advocating for the Commission's rejection of ORS witnesses Hunnell and Loy's direct testimonies. ORS's conduct is consistent in providing the Commission with the factual results of its review and in making appropriate recommendations that represent the public interest. Company witnesses Crawford and Daday's assertions are neither supported by any evidence nor are they true. Simply stated, Company witnesses Crawford and Daday, through their rebuttal testimonies, demonstrate that the Company is unwilling to accept the significant changes made by the General Assembly to the role of ORS in a rate case proceeding.

Q. COMPANY WITNESS CRAWFORD EXPRESSES CONCERN WITH YOUR RESPONSE TO HIS DIRECT TESTIMONY. PLEASE RESPOND TO HIS ASSERTION "THAT ORS ENGAGED WITH THE COMPANY IN AN ADVERSARIAL AND NON-CONSTRUCTIVE MANNER SINCE THE LAST RATE CASE."²

A. Company witness Crawford makes the assertion that ORS was adversarial and non-constructive for the simple reason that the Company did not achieve, through its discussions with ORS during the time period between March 2018 and July 2019, an

² PUI witness Crawford p.2 lines 5 and 6 Rebuttal Testimony.

1 agreement from the ORS on the “[i]nclusion of this \$18 million investment in the
2 Company’s rate bas[e].”³

3 As expressed in my direct testimony, I was directly involved in the discussions and
4 ORS has a different perspective on the efforts undertaken by ORS and PUI after the last
5 rate case to reach possible resolution of the ratemaking issues related to the PRC Assets
6 and the TCJA. Both issues are unique and important to the public interest and the
7 Company, which is why ORS diligently continued its efforts to resolve or narrow the issues
8 before the Company’s next rate case. ORS took its duty to serve as a facilitator to resolve
9 issues related to the PRC Assets and TCJA seriously despite the pressures and demands of
10 the nuclear construction abandonment regulatory process that was on-going during the
11 same time period.

12 Surrebuttal Exhibit DMH-1 includes a series of correspondence exchanged
13 between PUI and ORS from August 12, 2018, through July 6, 2019. The correspondence
14 demonstrates, contrary to the assertions of Company witness Crawford, that my direct
15 testimony statements are accurate and ORS and PUI engaged in good-faith on-going
16 dialogue. ORS and PUI explored the possibility of resolving the valuation issues related to
17 the PRC Assets and the unique impacts of the TCJA, specifically the establishment of and
18 the amount of a regulatory liability but were unable to come to an agreement on either
19 issue. Bottom line, PUI requested ORS take a position on the PRC Assets that is
20 inconsistent with ORS’s statutory responsibility to represent the public interest and ORS
21 refused to do so.

³ PUI witness Crawford p.2 lines 10 and 11 Rebuttal Testimony.

After a change in the statutory definition of public interest, ORS has faced criticism from the state's public utilities that ORS's recommendations are not supportive of the utility's financial integrity. ORS faces the same criticism here and nothing in the correspondence contained in Surrebuttal Exhibit DMH-1 supports Company witness Crawford's claim that ORS engaged with the Company in an non-constructive manner.

Q. PLEASE RESPOND TO COMPANY WITNESSES CRAWFORD AND DADAY'S SPECULATION THAT ORS ENGAGED IN RETALIATION BY INFORMING THE COMMISSION OF THE ACTUAL RESPONSES BY THE COMPANY TO ORS INFORMATION REQUESTS.

A. Company witnesses Crawford and Daday allege that the direct testimony of ORS witnesses Hunnell and Loy "[p]aints the Company in a false light"⁴ and ORS does so in "[r]etaliatio[n] for the Company having expressed its concerns to ORS at the February 19, 2020 meeting."⁵ The statements of ORS witness Hunnell that the Company finds objectionable are the subject of ORS's Motion for Leave to File Testimony and Exhibits under Seal. Certain portions of the direct testimony by ORS witnesses Hunnell and Loy are the subject of the Company's Motion to Strike Portions of Pre-Filed Direct Testimony and Exhibits and For Imposition of Sanctions.

Despite PUI's objections, the direct testimony of witnesses Hunnell and Loy are simply factually accurate representations of the Company's responses to ORS's questions. ORS witnesses Hunnell and Loy completed their investigation and made recommendations based on the best information they could obtain and analyze. Neither ORS witness "complains" of the Company's answers. Rather, the ORS witnesses state, in a factual

⁴ PUI witness Daday p. 27 line 15 Rebuttal Testimony.

⁵ PUI witness Daday p. 27 lines 8 and 9 Rebuttal Testimony.

1 manner, the responses ORS received from the Company. ORS witnesses Hunnell and Loy
2 do not state the Company was “uncooperative” or “has not cooperated in the ORS audit,
3 inspection and examination”⁶ in their direct testimony. In fact, none of the ORS witnesses
4 make any statements to indicate or suggest the Company or its representatives were
5 uncooperative with the ORS review.

6 It is imperative that ORS ask the Company questions in the course of its normal
7 rate case review and preparation. It is ORS’s duty to clarify and confirm the information
8 provided by the Company in its Application for rate relief is representative of the
9 Company’s operating experience and accurate. ORS takes its duty seriously to provide
10 complete information and recommendations to the Commission that are fully supported by
11 information gathered for the purpose of confirming the Company’s books, records and
12 testimony. Witnesses Hunnell and Loy have acted accordingly in this rate case. In the
13 wake of Act 258 which requires more transparency, not less, the simple fact that ORS asks
14 questions and provides the Company’s actual answers to the Commission is not an
15 indication that ORS’s conduct is improper, unfair, unprofessional, unequitable or
16 retaliatory. ORS has fulfilled its statutory duties as required by the General Assembly.

17 **Q. PLEASE DISCUSS ORS’S EFFORTS TO SERVE AS A FACILITATOR TO**
18 **RESOLVE DISPUTES AND ISSUES WITHIN THIS RATE CASE.**

19 **A.** After ORS filed its direct testimony on May 26, 2020, ORS provided a term sheet
20 outlining possible adjustments in the rate case where there was an opportunity for
21 settlement or compromise. ORS distributed this term sheet to each party. Although there
22 were constructive discussions by several of the parties about the adjustments outlined on

⁶ PUI witness Crawford p.4 line 1 and Daday p.27 lines 14 and 15 Rebuttal Testimony.

the term sheet, the parties in this case were unable to reach agreement or a partial compromise. ORS fulfilled its statutory duty to serve as a facilitator and PUI offers no evidence to the contrary.

Alternatives for Resolution of the PRC Assets and TCJA

Q. PLEASE IDENTIFY THE ALTERNATIVES FOR RESOLUTION THAT ORS WOULD ACCEPT AS AN OUTCOME IN THIS RATE CASE.

A. ORS continues to fully support the recommendations outlined in the ORS witnesses direct and surrebuttal testimonies and requests the Commission's approval of the ORS recommendations. However, ORS, consistent with its statutory duty to act directly to resolve disputes, presents alternatives for Commission consideration that ORS would accept as an outcome to resolve two (2) unique issues: 1) the proper valuation and ratemaking treatment of the PRC Assets ("PRC Asset Alternative") and, 2) the return to customers of the regulatory liability required by the Commission for excess federal corporate income tax expense embedded in rates charged to customers since January 1, 2018 due to the TCJA ("TCJA Alternative").

Q. PLEASE EXPLAIN THE PRC ASSET ALTERNATIVE AND YOUR REASON FOR PROPOSING AN ALTERNATIVE RESOLUTION TO THE VALUATION AND RATEMAKING TREATMENT OF THE PRC ASSETS.

A. ORS continues to fully support the recommendations offered to the Commission by witness Loy. The valuation and proper ratemaking treatment for the PRC Assets are complex and unique. In 2012, the PRC Assets were purchased by Palmetto of Richland County, LLC ("PRC") whose indirect parent company was Ni America Capital Management, LLC. In 2015, Ni Pacolet Milliken Utilities, LLC acquired the PRC Assets, PUI and a sister sewer utility Palmetto Wastewater Reclamation, LLC from Ni America

Capital Management, LLC. The Commission has not been previously presented with this exact set of circumstances related to the proper ratemaking treatment for an investor-owned utility for a portion of a sewer collection system that was acquired from a municipality. The Company's records and the Commission's Order in Docket No. 2012-273-S do not indicate the PRC Assets were operated by a non-viable municipality and the PRC customers were in danger of not receiving safe and reliable sewer service. In addition, the General Assembly has provided no specific policy direction to guide the Commission in its consideration of the proper ratemaking treatment for the PRC Assets. The Report by GDS concluded that "[g]reat care should be taken when litigating this issue since the Commission's final decision has the potential to lay the groundwork for any future cases similar in nature and/or legislation that may be needed to advance the public interest."⁷

In acknowledgement of the complexities presented by the manner in which and extent to which the City of Columbia kept records, lack of specific legislative guidance and the concern that customers should not pay twice for the PRC Assets, ORS proposes the PRC Asset Alternative for the Commission's consideration. The following PRC Asset Alternative is limited to the specific circumstances related to the valuation and ratemaking treatment for the PRC Assets:⁸

- 1) The Company's Original Cost Study is an acceptable means of estimating the value of the PRC Assets if the Consumer Price Index is replaced by with the Handy-Whitman indices.

⁷ ORS witness Loy Exhibit CEL-2 p.14 Direct Testimony.

⁸ This Alternative is limited in scope and applicable only to the PRC Assets in the instant docket and should have no precedential effect. The Commission should retain authority to consider the facts and circumstances the proper ratemaking treatment for utility acquisitions.

2) The Company should be allowed to recover the PRC Assets through customer rates. ORS calculates this amount as \$10,699,647 (Plant in Service \$25,423,487 less Accumulated Depreciation \$14,723,840 equals \$10,699,647).

3) The PRC Assets should be excluded from any calculations of rate base and return on rate base.

Surrebuttal Exhibit DMH-2 reflects the PUI Operating Experience, Rate Base and Rate of Return calculated to include the PRC Asset Alternative and all other adjustments as proposed by ORS.⁹ The increase in the revenue requirement equals \$2,185,000. The monthly rate for sewer service would be \$57.38 per equivalent residential connection (“ERC”). See Surrebuttal Exhibit DMH-3 for a reconciliation of the monthly rate and revenue requirement reflecting the PRC Asset Alternative set forth above. Surrebuttal Exhibit DMH-2 and DMH-3 were prepared at my direction by ORS witness Daniel Sullivan.

Q. PLEASE EXPLAIN THE TCJA ALTERNATIVE AND YOUR REASON FOR PROPOSING AN ALTERNATIVE RESOLUTION TO THE RETURN TO THE CUSTOMERS OF THE REGULATORY LIABILITY REQUIRED BY THE COMMISSION FOR EXCESS FEDERAL CORPORATE INCOME TAX EXPENSE EMBEDDED IN RATES CHARGED TO CUSTOMERS SINCE JANUARY 1, 2018 DUE TO THE TCJA.

A. ORS continues to fully support the recommendations offered to the Commission by witnesses Hunnell and Daniel F. Sullivan. Since the TCJA became effective, the Commission has approved the return of the regulatory liability to customers. In no rate

⁹ PUI’s calculation of property tax as filed in the Application is incorporated in Surrebuttal Exhibit DMH-2.

1 proceeding since 2018, has the Commission allowed the utility to retain the money
2 customers have paid to the utility through rates for federal corporate income tax expense
3 the utility did not actually incur. The Commission, by approving the return of these funds
4 to utility customers, albeit without interest, recognizes that the utility should not be the
5 recipient of a windfall at the expense of its customers. In considering equitable solutions
6 to return the regulatory liability to customers, the Commission has approved various
7 methods proposed by the utilities and the ORS. None of the Commission's ruling on the
8 TCJA have been appealed.

9 In an effort to reach an equitable solution that reflects the methods approved by the
10 Commission,¹⁰ ORS proposes the following TCJA Alternative for the Commission's
11 consideration related to the TCJA:

12 1) The Company will establish a regulatory liability attributed to the excess federal
13 income tax expense and return the regulatory liability to customers through a
14 temporary TCJA decrement rider.

15 2) The amount of the regulatory liability attributed to the excess federal income
16 tax expense is \$1,321,512 and reflects the time period of January 1, 2018 through
17 August 6, 2020 with the expected date of new effective rates of August 7, 2020.

18 3) The TCJA decrement rider will be in effect for thirty-six (36) months or until
19 such a time as the total balance of the regulatory liability reaches zero.

20 Surrebuttal Exhibit DMH-4 reflects the TCJA Alternative calculation of the regulatory
21 liability for excess tax expense. Surrebuttal Exhibit DMH-4 was prepared at my direction
22 by ORS witness Sullivan. The temporary TCJA decrement rider would be reflected on

¹⁰ The Alternative proposed by ORS is calculated in the same way as the regulatory liability in Docket No. 2019-64-WS CUC, Inc. and 2018-257-WS Kiawah Island Utility, Inc. See Surrebuttal Exhibit DMH-4.

1 customers' bills monthly in the amount of (\$1.07) per ERC (\$1,321,512 / 34,290 ERCs /
2 36 months).

3 **Q. WILL YOU UPDATE YOUR SURREBUTTAL TESTIMONY BASED ON**
4 **INFORMATION THAT BECOMES AVAILABLE?**

5 **A.** Yes. ORS fully reserves the right to revise its recommendations via supplemental
6 testimony should new information not previously provided by the Company, or other
7 sources, becomes available.

8 **Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

9 **A.** Yes, it does.

Palmetto Utilities, Inc.

1710 Woodcreek Farms Road, Elgin SC 29045

August 14, 2018

Sent via email & USPS

Ms. Nanette Edwards
Executive Director
South Carolina Office of Regulatory Staff
1401 Main Street, Suite 900
Columbia, S.C. 29201

Re: Palmetto Utilities, Inc. (Palmetto) Rate Base at Palmetto of Richland County (PRC)

Dear Ms. Edwards:

Enclosed is a Gannett Fleming report dated August 2018 (the "Gannett Fleming Report")¹ that provides information regarding the calculation of Palmetto's rate base in its PRC territory, including the impact of CIAC on that calculation. This Report will be a key fact underlying our positions going forward.

ORS/Palmetto Meetings

We have discussed this rate base/CIAC issue a number of times with no resolution. As a separate issue, the ORS requests that Palmetto agree to (1) the ORS's calculation of the impact of the 2018 Tax Act and (2) its retroactive application back to January 1, 2018 (the "Tax Issue"). We believe, based on opinion of counsel, that the ORS position is impermissible retroactive rate-making and that its calculation of the Tax Act's impact is incorrect in certain respects. Nonetheless, we could obviously consent to the ORS position if we could resolve the rate base/CIAC issue in a manner acceptable to both parties.

We have met with the ORS three times in the last two months. Each time, we felt like we had agreed on a path forward. Our understanding from our most recent meeting was that ORS would get a third party report on PRC rate base/CIAC, and based on that, come to some agreement (and coincidentally, we would consent to the ORS position on Tax Issue at that time).² To better understand the CIAC valuation issue and to give our board an independent review, after our last meeting we engaged a third-party valuation firm (Gannett Fleming) to assess the issue. We procured our report, but now understand it is impossible for the ORS to procure such a report in the near term.

Prior Rate Case

We heard that the ORS was frustrated at our request for another meeting. With everything going on in the State, we can understand your frustration. However, please know that we likewise, are extremely frustrated and disappointed in how Palmetto was treated in the regulatory process.

¹ Gannett Fleming is a 100-year-old national firm with over 2,000 professionals and significant experience in the water/wastewater sector.

² We understand that the ORS cannot tie the Tax Issue to PRC's rate base calculation. However, we may condition our consent to what we believe is an invalid ORS position on taxes, on resolving PRC's valuation. We simply want to ensure that we get a reasonable resolution of the PRC rate base issue before giving up something (again). As we explain in this letter, we have every right to believe that we will not be treated fairly in the regulatory process.

In the face of the VC Summer debacle and other wastewater companies creating a host of problems (and bad press) for our state, our rivers and the ORS, Palmetto has been a great example of how a wastewater company should be run. We have addressed our problems and growth issues proactively, and even solved ORS "problem areas" like Alpine/Woodlands. We have only sought recovery for used / useful capital expenditures. These expenditures, which totaled \$80 million, will allow Palmetto to operate efficiently and comply with increasingly stringent environmental standards for years to come (and based on the growth we're seeing in northeast Richland County and Elgin area, it was critical that we do so). As you know, we are owned by a South Carolina family and had hoped to continue making investments in South Carolina infrastructure including fixing up systems like Alpine and Woodland utilities. I'm afraid the family and independent board members have lost confidence in making future investments in the state due to the current regulatory environment.

We understood that the rate impact of everything we have spent would be significant -- though not significant enough to put us at the top of peer rates even if 100% were recognized immediately.

In the rate case, the ORS disallowed most of our interest expense, gave us zero plant value on a collection system for 11,182 customers, took tax positions that the PSC reversed, and refused to annualize new expenses for the threemajor capital projects, among other things. The net result was that we have a low single digit return, even though we did everything right. More importantly, this resulted in our losing faith in the regulatory process. The ORS could have acknowledged our positions and simply asked us to spread the increase over several years. Instead, it took untenable positions, in an effort to achieve a dollar target.

Summary of Gannett Fleming Report

The Gannett Fleming Report concludes:

- The amount of customer cash CIAC that would reduce PRC rate base at the time of purchase of PRC should be zero.
- This conclusion is due to fact that PRC did not buy the wastewater treatment plant; instead, it purchased the customers and collection system. *Notably, the "Expansion Fee" (cash CIAC) that was paid by customers, went 100% for the treatment plant. This is based on disclosures in City of Columbia bond filings and consistent with PSC regulations*

Thus, we did not get the benefit of the CIAC and the customers would not "pay twice" if we do not reduce plant value by the "Expansion Fee." (As a further test, \$18 million for a collection system for 11,182 customers is not, on its face, excessive.)

We continue to agree, however, that the property donated by developers and listed in PRC's Asset Purchase Agreement is accumulated CIAC and should go to reduce the original \$18 million of plant value (rate base). That amount, based on the Joel Wood Valuation report you previously received, has an amortized net value of approximately \$700,000 at the time of purchase.

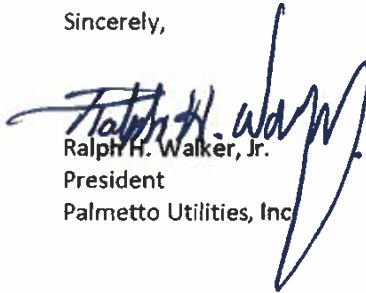
Summary

Your position is that there is insufficient time for the ORS to procure a third party report on the PRC rate base issue before your desired resolution date of the Tax Issue, and we should trust that you will agree to

a fair resolution regardless of the facts. Based on our treatment in the last rate case, we cannot trust the process.

Thus, our course is set. We are obviously willing to have further conversations via phone or in person, but we thought it only fair if we laid out our thoughts in a clear, unvarnished manner.

Sincerely,



Ralph H. Walker, Jr.
President
Palmetto Utilities, Inc

Attachments: (Gannett Fleming Report and Joel Wood Valuation)



Nanette S. Edwards
Executive Director

STATE OF SOUTH CAROLINA
OFFICE OF REGULATORY STAFF

1401 Main Street
Suite 850
Columbia, SC 29201

August 27, 2018

Ralph Walker
President
Palmetto Utilities, Inc.
1710 Woodcreek Farms Road
Elgin, SC 29045
Via e-mail and USPS

Subject: Response to Palmetto Utilities, Inc. August 14, 2018 Correspondence

Dear Mr. Walker,

I received your letter on August 15, 2018, related to your concerns centered around the regulatory process, the impact of the 2018 Tax Cuts and Jobs Act ("TCJA") and Palmetto Utilities, Inc. ("PUI") rate base calculation for the assets purchased from the City of Columbia in 2013. While I understand a meeting is scheduled between PUI and the SC Office of Regulatory Staff ("ORS") to continue discussions related to TCJA, I feel it necessary to address each issue in a responsive letter to accurately clarify ORS's position on each topic.

Meetings between PUI and ORS Representatives of ORS and PUI discussed the impacts of the TCJA to understand the challenges faced by a wastewater utility due to the 2018 change in the federal income tax rate from 35% to 21%. As discussed during these each of these phone calls and meetings, ORS committed to retain the services of a third-party expert to review PUI's calculations of the rate base and contributions in aid of construction ("CIAC") acquired from the City of Columbia in 2013. The review by an expert will be conducted in coordination with PUI's next general rate case which is expected in late 2018 or early 2019. ORS offered to put this commitment in writing for PUI.

Notwithstanding ORS's commitment to retain an expert for the next general rate case to study the rate base and CIAC issues, ORS clearly communicated in each of the meetings with PUI that ORS will not resolve the PUI rate base and CIAC valuation issues in return for PUI's cooperation in Docket No. 2017-381-A.

Status of the TCJA Implementation (Docket No. 2017-381-A)

The Public Service Commission of South Carolina ("Commission") recently scheduled oral arguments in Docket No. 2017-381-A for October 11, 2018, to reconsider the issues identified by PUI and its sister utility, Palmetto Wastewater Reclamation, LLC related to Order 2018-370. ORS will continue to work with interested water/wastewater utilities toward a resolution.

Status of the Third-Party Expert

In Docket No. 2017-228-S, ORS and PUI agreed via stipulation to address the valuation of the assets acquired from the City of Columbia in the next general rate proceeding. Toward that effort, ORS discussed the scope of work with an engineering consulting firm earlier this month. ORS is formalizing the scope of work and gathering names of other possible consulting firms. ORS will share the scope of work with PUI prior to requesting pricing from the consulting firms.

It is ORS's expectation to select a vendor by the end of November 2018. ORS will share the Gannett Fleming opinion and the report generated by Joel E. Wood Associates, LLC with the consulting firm selected for the project.

Prior Rate Case

You express frustration with the outcome of the 2017 rate case specifically with the Commission's ruling in the following areas:

- Interest synchronization;
- Acceptance of the stipulation between PUI and ORS to address the valuation of assets acquired from the City of Columbia in the next rate case; and
- Annualization of operations and maintenance expenses related to a newly operating treatment plant.

While ORS and PUI were not in agreement on several of the above issues, no Party sought reconsideration of the Commission's order. ORS continues to work diligently toward retaining an expert consultant to assist with the asset valuation.

I appreciate your letter and I trust you will find my response helpful to clarify ORS's position on these issues. I look forward to continued meetings and am hopeful that progress will be made.

Sincerely,



Nanette S. Edwards
Executive Director

From: [Edwards, Nanette](#)
To: [Hipp, Dawn](#); advisor
Subject: Fwd: [External] PRC Rate Base Issue
Date: Saturday, July 6, 2019 6:04:43 PM
Attachments: [Pacolet Rate Base Issue.docx](#)
[PRC Rate Base Issue.docx](#)

Sent from my iPhone

Begin forwarded message:

From: William Crawford <William.Crawford@pacoletmilliken.com>
Date: July 6, 2019 at 12:12:50 PM EDT
To: "nedwards@ors.sc.gov" <nedwards@ors.sc.gov>
Cc: Mark Daday <mdaday@niamerica.com>, Ralph Walker <Ralph.Walker@pacoletmilliken.com>
Subject: [External] PRC Rate Base Issue

Nanette – I hope you had a good Fourth.

We wanted to send our commentary on the GDS Report so that you might get a sense of our thinking in advance of our Tuesday meeting. We're willing to work with the ORS on this PRC rate base and the tax issue, and want a constructive conversation, but this GDS Report was so poorly done, that it is not a reasonable starting point. We go into greater detail in the Memo, but among other things, it bases its conclusion (something it "surmises" is "most likely" true) on a single accounting entry from the City, which has been judicially recognized as using wastewater revenues as a slush fund – all while providing *zero* background. It does not remotely come close to providing a sufficient factual basis for any decision.

Anyway, please forward this internally to your Staff as you deem appropriate, and we will look forward to seeing you on Tuesday. Thanks. WPC

William P. Crawford, Jr.
Chief Operating Officer | Pacolet Milliken, LLC
550 South Main Street, Suite 601 | Greenville, SC 29601
m: 864.420.0638 | o: 864.342.6177
William.Crawford@pacoletmilliken.com

Memorandum

To: ORS Staff
From: Palmetto Utilities, Inc.
RE: GDS Report
Date: July 1, 2019

We have reviewed the GDS Associates Report dated June 5, 2019 (the "GDS Report") that purportedly seeks to determine the value of donated property included among the assets purchased by Palmetto of Richland County ("PRC") from the City of Columbia.

The GDS Report is, without question, extremely poor work product. Among other things, it "surmises" its principal conclusion, reflects zero evidence to support its "surmising"¹ (other than the single unsupported accounting entry), and is internally inconsistent in at least three key respects. It concludes by meandering around in a policy discussion that is interesting but for the fact GDS wasn't tasked with doing that, and it does not provide a solution for the issue at hand because legislative action would likely be required to effectuate its musings.

Their principal task was -- as the title of the Report references -- to determine the amount of donated property that PUI (PRC) received from the City of Columbia. One would expect to see statements of investigation, persons contacted, lists of assets, definitions/analysis of City fees, descriptions of total CIAC, purported uses of specific CIAC and any commentary that third parties (courts, accountants, etc.) have made regarding the City's collection and use of CIAC. One would also expect GDS to reference discussions with the head of the wastewater division, a senior financial officer or other people in the know to illuminate what might otherwise be ambiguous data.

Notably, however, except for the single accounting entry, no such investigation is documented. And regarding that single entry -- no references whatsoever were made regarding the City's work papers to explain it in any respect. Of course, if that information isn't available, one should acknowledge that. Instead based on virtually no facts, GDS proceeds to "surmise" that something was "*most likely*" donated or "*could be considered*" donated property. No reasonable utility with fiduciary responsibilities to its shareholders could ever except such a conclusion. In short, this GDS Report is not a professional piece of work that can serve as the basis for anything other than a policy paper.

GDS Conclusion

Quoting the Task 1 section from the GDS report:

*"We requested and obtained the accounting entry that was made by the City...[and from] the accounting entry, we **surmised** that all but about \$1.29 million of the net plant purchased was either donated or contributed to the City. Therefore, we estimate that \$16.71 million of the \$18 million purchase price is **most likely** donated."*

¹ Per Merriam-Webster, the term "surmise" (in the noun form) is a "thought or idea based on scanty evidence." This is a highly appropriate term in this context.

This is not Las Vegas. We aren't into measuring probabilities here – particularly when zero explanation is given as to why they are surmising and reaching these equivocal conclusions.

Further down in the Task 1 section, the urge to explain rises again:

*Thus, assuming the PUI OCS value of \$18 million is correct, the City's accounting entry valuing and identifying (or listing) the non-contributed plant (for the plant purchased/built and booked by the City) we **believe** about \$16.71 million **could be considered** as donated and/or contributed property.*

That isn't a perfectly constructed sentence – but GDS is simply assuming the City's accounting entry is correct. Of course, they make exactly zero explanation of who, where, when or why that entry was made, what it was subsequently used for, or what if any backup exists regarding it, etc. etc. And based on this key unexplained "assumption", they conclude "*about \$16.71 million **could be considered** as donated and/or contributed property.* That is an unacceptable methodology to Palmetto Utilities.

Inconsistencies

The GDS Report is inconsistent in three key respects.

1. First, GDS points out that under GASB, municipalities like the City, must book CIAC to equity (not an asset and corresponding liability). However, the accounting entry that GDS relies upon to surmise its conclusion is completely inconsistent with this. The City's records do not reflect a booking of CIAC as equity. Now the fact that the City doesn't keep proper accounting records is certainly not GDS's fault. But by the same token, GDS should readily agree that the accounting entry becomes fatally suspect if it does not comply with proper accounting standards.
2. Second, on Diagram 4 on page 11, GDS references "Treatment Plant CIAC". GDS's premise is that CIAC funded property that was transferred to PRC. However, these expansion fees (called the Plant Expansion Fee by the City of Columbia) were precisely that – fees funding the treatment plant. This is the key point -- PRC did not acquire the City's treatment plant – and thus these funds did not fund property donated to PRC.
3. Lastly, GDS concludes that PUI should have booked an original cost "closer to \$15.4 million than the \$18 million proposed by PUI." (We disagree with the reasons, but that is irrelevant for this purpose). Yet when GDS calculates the amount of donated property, it subtracts it from the \$18 million. This is of no import other than it shows the lack of internal consistency within this Report.

The first inconsistency above merits more discussion. GDS relies exclusively on a single accounting entry made by someone in the City. However, it is a matter of judicial record that the City, for decades, utilized revenues from its sewer operations to defray general fund expenses. Notably, the South Carolina Supreme Court, in its 2015 opinion in *Azar v. City of Columbia*, found the City's accounting practices in this regard to be a highly questionable, characterizing the City's practice as "allowing these revenues to be treated as a slush fund" and used for other purposes. As an aside – and on a tangential out-of-scope issue – we note that GDS uses the Handy-Whitman Index, which is a water (not wastewater) index. This is just one more example of the shoddy work product, in what was an effort to generate as low a number as possible.

The most critical issue in this inquiry is "*what were the CIAC payments from customers used for by the City.*" If they were not applied to PRC-purchased assets, then there is no donated property at issue here, and the parties are back to debates around PUI's original cost estimate (which the ORS did not dispute and GDS seemed to accept). Thus, for GDS to blithely accept this accounting entry as its sole basis of

support --- with *zero* other evidence/commentary, and in the face of a SC Supreme Court opinion saying the City's accounting practices around its wastewater revenues were highly suspect-- is reckless.

Months ago, while awaiting the engagement of GDS, we urged the ORS to allow us to speak with GDS (with staff present) to ensure that they did not fail to address questions necessary for the report to be responsive. We are precisely in that situation. The GDS Report is so flawed, that it is useless. Furthermore, if you read between the lines of the GDS Report, you realize that GDS cannot really believe their conclusion. Otherwise, they wouldn't have --without solicitation -- referenced what other states are doing in these situations, or urged everyone to find a "reasonable solution". That is an implicit acknowledgement that their conclusion is unreasonable.

In conclusion, we are in fundamental disagreement with GDS's valuation of the PRC CIAC (and thus the PRC valuation). Moreover, PUI is in a situation where it spent \$75 million dollars on used, useful operating assets that the ORS has never questioned -- assets on which we are earning a 3.5% return. In addition, we are at odds with the ORS on the tax issue--irrevocably so. Unfortunately, we see no alternative but litigation, both in the judicial courts, and in the court of public opinion. We look forward to discussing these issues, and this GDS Report in that context.

Palmetto Utilities, Inc.
Docket No. 2019-281-S
Operating Experience, Rate Base and Rate of Return
For the Test Year Ended August 31, 2019
ORS ALTERNATIVE TO RESOLVE THE PRC ASSET RATEMAKING TREATMENT

Description	(1) Application Per Books \$	(2) Accounting & Pro Forma Adjustments \$	(3) After Accounting & Pro Forma Adjustments \$	(4) ORS Adjustments \$	(5) After ORS Adjustments \$
<u>Utility Operating Revenues:</u>					
Wastewater Sales Revenues	20,156,156	1,317,532	(1A) 21,473,688	2,175,741	(18A) 23,649,429
Other Wastewater Revenues	1,157,066	(61,881)	(1B) 1,095,185	9,259	(18B) 1,104,444
<u>Total Utility Operating Revenues</u>	<u>21,313,222</u>	<u>1,255,651</u>	<u>22,568,873</u>	<u>2,185,000</u>	<u>24,753,873</u>
<u>Utility Operating Expenses:</u>					
Operating Expenses	5,632,277	2,704,918	(2) 8,337,195	38,893	(19) 8,376,088
Depreciation and Amortization	4,354,186	(167,393)	(3) 4,186,793	0	4,186,793
Rate Case Expenses	686,665	4,774	(4) 691,439	0	691,439
Taxes Other Than Income Taxes	3,602,038	617,718	(5) 4,219,756	11,521	(20) 4,231,277
Income Taxes	(4,311,776)	5,083,013	(6) 771,237	532,579	(21) 1,303,816
<u>Total Utility Operating Expenses</u>	<u>9,963,390</u>	<u>8,243,030</u>	<u>18,206,420</u>	<u>582,993</u>	<u>18,789,413</u>
<u>Total Net Utility Operating Income (Loss)</u>	<u>11,349,832</u>	<u>(6,987,379)</u>	<u>4,362,453</u>	<u>1,602,007</u>	<u>5,964,460</u>
Other Income and Deductions	135,479	(128,075)	(7) 7,404	0	7,404
Add: Customer Growth	0	60,420	(8) 60,420	22,188	(22) 82,608
Less: Amortization of EDIT	0	(59,089)	(9) (59,089)	0	(59,089)
<u>Net Income for Return</u>	<u>11,485,311</u>	<u>(6,995,945)</u>	<u>4,489,366</u>	<u>1,624,195</u>	<u>6,113,561</u>
<u>Original Cost Rate Base:</u>					
Plant in Service	185,672,411	(26,025,535)	(10) 159,646,876	0	159,646,876
Accumulated Depreciation	(56,244,271)	14,212,800	(11) (42,031,471)	0	(42,031,471)
Contributions in Aid of Construction (CIAC)	(58,602,697)	(3,083,486)	(12) (61,686,183)	0	(61,686,183)
Accumulated Amortization of CIAC	24,312,959	1,456,122	(13) 25,769,081	0	25,769,081
Net Plant	95,138,402	(13,440,099)	81,698,303	0	81,698,303
Accumulated Deferred Income Taxes	(81,654)	(4,894,748)	(14) (4,976,402)	0	(4,976,402)
Excess Deferred Income Taxes (EDIT)	0	(1,146,916)	(15) (1,146,916)	0	(1,146,916)
Materials and Supplies	477,552	0	477,552	0	477,552
Prepayments	161,571	0	161,571	0	161,571
Cash Working Capital	1,154,289	(25,710)	(16) 1,128,579	0	1,128,579
<u>Total Rate Base</u>	<u>96,850,160</u>	<u>(19,507,473)</u>	<u>77,342,687</u>	<u>0</u>	<u>77,342,687</u>
<u>Return on Rate Base</u>	<u>11.86%</u>		<u>5.80%</u>		<u>7.90%</u>
<u>Operating Margin</u>	<u>34.33%</u>		<u>10.81%</u>		<u>16.42%</u>
<u>Interest Expense</u>	<u>4,169,321</u>	<u>(2,119,353)</u>	<u>2,049,968</u>	<u>0</u>	<u>2,049,968</u>

Office of Regulatory Staff
ORS Calculated Revenues to reflect ORS Alternative for the PRC Assets
Palmetto Utilities, Inc.
Docket No. 2019-281-S

SURREBUTTAL EXHIBIT DMH-3

Calculated Total Company Test Year Revenue Overview

Customer Classification	Equivalent Residential Connection (ERC) ¹	Monthly Rate ²	Test Year Calculated Revenues
Residential	356,410	\$52.10	\$18,568,972
Commercial & Industrial	51,538	\$52.10	\$2,685,146
Dump Station ⁴	683	\$52.10	\$35,579
Sewer Service Revenue	408,631		\$21,289,697
Misc. Other Revenue ⁵			\$1,157,066
Total Company Sewer Operating Revenues			\$22,446,763

Calculated Total Company Test Year Revenue Using the Actual Number of ERCs as of 02/29/2020

Customer Classification	Equivalent Residential Connection (ERC) ³	Monthly Rate ²	ORS Calculated Revenues @ 02/29/2020	Increase (%)	Company Test Year Calculated Revenues	ORS Difference
Residential	359,352	\$52.10	\$18,722,240	0.82%	\$18,568,972	\$153,268
Commercial & Industrial	52,128	\$52.10	\$2,715,869	1.13%	\$2,685,146	\$30,723
Dump Station ⁴	683	\$52.10	\$35,579	0.00%	\$35,579	\$0
Sewer Service Revenue			\$21,473,688		\$21,289,697	\$183,991
Misc. Other Revenue ⁵			\$1,095,185		\$1,157,066	-\$61,881
Total Sewer Operating Revenues			\$22,568,873		\$22,446,763	\$122,110

ORS Calculated Revenue PUI Total Company After ORS Adjustments and reflecting the ORS Alternative for the PRC Assets

Customer Classification	Equivalent Residential Connection (ERC) ³	Monthly Rate	ORS Calculated Revenues After ORS Adjustments	Increase (%)	ORS Calculated Revenues @ 02/29/2020	ORS Adjustment
Residential	359,352	\$57.38	20,619,201	9.20%	\$18,722,240	\$1,896,961
Commercial & Industrial	52,128	\$57.38	2,991,044	9.20%	\$2,715,869	\$275,175
Dump Station ⁴	683	\$57.38	39,183	9.20%	\$35,579	\$3,604
Sewer Service Revenue			\$23,649,429		\$21,473,688	\$2,175,741
Misc. Other Revenue ⁵			\$1,104,444		\$1,095,185	\$9,259
Total Sewer Operating Revenues			\$24,753,873		\$22,568,873	\$2,185,000

1 Exhibit B; Schedule C of Company Application
2 Exhibit B; Schedule C of Company Application
3 Exhibit DPH-6

Office of Regulatory Staff SURREBUTTAL EXHIBIT DMH-4
Excess Tax Expense Regulatory Liability
Palmetto Utilities, Inc.
Docket No. 2019-281-S

ORS ALTERNATIVE TO RESOLVE THE TCJA REGULATORY LIABILITY

<u>Line No.</u>	<u>Item</u>	<u>Docket No. 2019-281-S .</u>	
		<u>Exhibit DMH-1 Pro-</u> <u>Forma Column at 34%</u> <u>Federal Income Tax</u> <u>Rate</u>	<u>Reflect 21%</u> <u>Federal Income</u> <u>Tax Rate</u>
1	Operating Revenues	\$ 22,568,873	\$ 22,568,873
2	Operating Expenses	13,215,427	13,215,427
3	Taxes Other Than Income Taxes	4,219,756	4,219,756
4	Interest Expense	2,049,968	2,049,968
5	Interest Income	7,404	7,404
6	Taxable Income (L1 - (Sum (L2 through L4) + L5)	\$ 3,091,126	\$ 3,091,126
7	State Income Tax (L6 * 5.0% Tax Rate)	154,555	154,555
8	Federal Income Tax ((L6-L7) * Tax Rate)	998,434	616,680
9	Net Income (L6 - L7 - L8)	\$ 1,938,137	\$ 2,319,891
10	Add back: Interest Expense (L4)	2,049,968	2,049,968
11	Net Income for Return (L9 + L10)	<u>\$ 3,988,105</u>	<u>\$ 4,369,859</u>
12	Cumulative Change in Net Income for Return		\$ 381,754
13	Retention Factor		75.05%
14	Annual Revenue Impact of Cumulative Change		\$ (508,666)
15	Daily Revenue Impact (L14/365)		\$ (1,394)
16	Regulatory Liability Calculation (1/1/18 - 8/6/20)		\$ (1,321,512)